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SUPREME COURT OF THE UNITED STATES

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No. ~~1389~~

1967

B & L FARMS CO. and MAY SPACH, EDWIN L. HUBBARD and JOHN NICHOLAS, as Trustees in Bankruptcy for B & L Farms Co.,

Petitioners,

vs.

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

To the Honorable Earl C. Warren, Chief Justice of the Supreme Court of the United States, and the Associate Justices of the Supreme Court of the United States.

The petitioners, B & L FARMS CO. and MAY SPACH, EDWIN L. HUBBARD and JOHN NICHOLAS, as Trustees in Bankruptcy for B & L Farms Co., respectfully pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit, entered in the above cause on December 1st, 1966, on which a petition for rehearing, duly and timely filed,

was denied by opinion dated February 15th, 1967, and judgment was entered on February 15th, 1967, upon which the mandate of the United States Court of Appeals for the Fifth Circuit was issued on the 23rd day of February, 1967.

OPINIONS BELOW

The opinion of the United States District Court for the Southern District of Florida, dated the 15th day of June, 1964, is reported in *Federal Supplement, Volume 238, page 407*. Judgment on said opinion was filed July 30th, 1964. A petition for new trial and rehearing was filed timely (see Record, p. 59), and a new opinion and order on rehearing, dated February 19, 1965, is reported in 238 F. Supp. 407, and is also contained in the printed record at pages 41 through 55, both inclusive, and opinion and order on rehearing, beginning at page 79 of the printed record, through page 85.

The opinion of the United States Court of Appeals for the Fifth Circuit, dated December 1, 1966, is not yet reported in the Federal Reporter, Second Series, but a copy of said opinion is attached hereto as Appendix "A". A copy of said opinion is also attached to the printed record, certified by the Clerk of the United States Court of Appeals for the Fifth Circuit. The opinion of the United States Court of Appeals for the Fifth Circuit denying the petition for rehearing was filed February 15, 1967. A certified copy of said opinion is attached to the printed record, and a true copy is attached to this petition as Appendix "B". The judgment and mandate of the Court was entered on the 23rd day of February, 1967, a copy of the same being certified to as a part of the original record.

JURISDICTION

The judgment of the United States Court of Appeals for the Fifth Circuit was made and entered on the 1st day of December, 1966, and recorded on December 1st, 1966, and a copy thereof as above referred to is attached to this petition as Appendix "A". The petition for rehearing was timely filed and that petition for rehearing was denied on February 15th, 1964, and final judgment of the Court and mandate was issued on the 23rd day of February, 1967, all shown in the Appendix attached hereto and above referred to.

The petition is filed timely (Title 28, U.S.C., § 2101 (c)). The jurisdiction of the Supreme Court of the United States is invoked under the provisions of Title 28, U.S.C., § 1254, as a certiorari from the final judgment or decree by the United States Court of Appeals for the Fifth Circuit.

QUESTIONS PRESENTED

The questions presented are duly and ably set forth in the opinion of the United States District Court for the Southern District of Florida, as reported in 238 F. Supp. 407.

B & L Farms Co., a Florida corporation, was incorporated in 1949. The corporation was engaged in the production and packing of tomatoes and other produce. The books and records from 1949 until 1954 were kept on a cash receipts and disbursements basis and the income tax of the company was reported on a fiscal year basis, commencing August 1st of each year and ending July 31st of the next year.

In compliance with the amendments relating to corporations in the 1954 Code, the main part of the books was continued to be kept on a cash receipts and disbursements basis, with certain limited items transferred to the accrual basis. As of August 1st, 1958, the beginning of the new fiscal year, a Chapter XI arrangement proceeding was filed by the corporation in the United States District Court for the Southern District of Florida (Pretrial Stipulation—R. 21).

The law in effect in 1959 (11 U.S.C., § 724; § 324 of the National Bankruptcy Act applicable to Chapter XI proceedings) required the filing of complete schedules. All creditors were required to be included and all debts, whether secured or unsecured, or whether liquidated or unliquidated, fixed or contingent, were required to be shown in the schedules (see 11 U.S.C., § 707, ¶¶ (1) and (2), also known as § 307, National Bankruptcy Act, ¶¶ (1) and (2)). The trade creditors required to be shown in the schedules as of August 1, 1958, included all of the trade creditors referred to in the opinion of the lower Court as being in the amount of approximately $2,459,-618.00.

As will be hereinafter pointed out, the petitioners contend that the book accounting and auditing arrangements, regardless of what they had been prior to August 1st, 1958, were transferred by operation of law to the accrual basis, and upon passing of the title to all of the assets, first to the Receiver in the Chapter XI proceedings and subsequently to the Trustees in Bankruptcy, in the same fiscal year payment was made on these debts which had been accrued by operation of law. The terms of the Bankruptcy Act would control in that instance over any of the provisions of the Internal Revenue Code or the regulations as to the technicality of accounting (*U. S.* v. *Bradley*, C.C.A. 5, 321 F. 2d 224).

In the operation under the plan of arrangement there were additional purchases from the trade creditors, and the farming operations continued but suffered additional losses. On June 26th, 1959, about five weeks before the close of the August 1st, 1958-July 31st, 1959 fiscal year, the company was adjudicated a bankrupt, and the individual Trustees, May Spach, Edwin L. Hubbard and John Nicholas, were appointed as Trustees in Bankruptcy for B & L Farms Co.

It is undisputed, as shown in the opinion of the lower Court, that there was the sum of $162,538.73, the amount which had been previously paid for income taxes, which was subject to adjustment and would have been applied as a net operating loss carry-back. A claim was made for refund after the claim had been denied by the Internal Revenue Service. Suit was then brought by the Trustees in the United States District Court for the Southern District of Florida.

The basis for the suit filed in the United States District Court is set forth in the opinion of the District Court, as shown in the reported decision in 238 F. Supp. 407 (see page 409, second column), as follows:

> "Plaintiffs contend that a larger net operating loss for fiscal year 1959 can be established, because of the transfer of all corporate assets to the trustees on June 26, 1959, by any one of the following deductions:
>
> (1) Deduction under 26 U.S.C., § 162 for business expenses due to the trade account indebtedness incurred during fiscal year 1959.
>
> (2) Deduction under 26 U.S.C., § 165 for a business loss because of the divestiture of the bankrupt's assets to the trustees.

(3) Deduction under 26 U.S.C., § 167 for a sudden obsolescence loss because of the abnormal retirement of the depreciable packing house and machinery at the time of the bankruptcy.

It is conceded that any one of these deductions, if valid, would be sufficient in amount to permit the refund claimed in this case."

As set forth in said opinion, the lower Court has analyzed these claims by separate discussion (see text, beginning page 409, 238 F. Supp. 407). The lower Court held against the Trustees' claims under Section 162, 26 U.S.C., because the corporation had been on a cash receipts and disbursements basis and the claims to the trade creditors were not actually paid or distributed to the creditors within the fiscal year ending July 31, 1959.

The lower Court relied upon the decision in the case of *B. J. Lake, Inc.* v. *Commissioner of Internal Revenue,* (C.C.A. 5) 148 F. 2d 898, wherein the Court construed the statute, then being 26 U.S.C.A., Internal Revenue Code, Section 24(c), as requiring an actual payment by a corporation to one of its officers within the calendar or fiscal year and within two and one-half months thereafter. Nothing was paid within two and one-half months after the end of the taxable year, but the taxpayer contended there was a constructive payment. The question now arises in the case at bar as to whether that case is controlling or whether the case of *Stuart* v. *Commissioner,* 38 B.T.A. 1147, which we contend is directly in point in favor of the Trustees, would control. The United States Court of Appeals, Fifth Circuit, in its opinion of December 1, 1966, now under review, by a two to one opinion affirmed the trial Judge without any opinion, but a dissenting opinion by Circuit Judge Brown clearly pointed out that the majority opinion affirming the lower Court was in

error because the effect of Section 70 of the Bankruptcy Act, 11 U.S.C.A., § 110(a), had been completely overlooked or ignored by the lower Court and by the majority of the United States Court of Appeals for the Fifth Circuit.

The United States Board of Tax Appeals in the case of *Stuart* v. *Commissioner*, supra, a copy of which is set forth in Appendix "C", as will be pointed out further in this petition, laid down certain principles of law and applied facts to that principle of law similar to the point before the Court, and if the holding of the Board of Tax Appeals in the Stuart case, supra, is the correct enunciation of the law, then the lower Court and the majority opinion of the United States Court of Appeals, Fifth Circuit, should be reversed. The doctrine of the B. J. Lake, Inc., case, supra, does not involve any intervening bankruptcy, and it is submitted by the petitioners that that case has no bearing upon the issues.

The first opinion of the lower Court (see 238 F. Supp. 407) made a brief comment concerning the Stuart v. Commissioner decision, supra, and recognized that the Stuart case was applicable, but it was merely the exception that proves the rule. However, the Court said (see text, p. 411), that the principle in the Stuart case was later rejected in *Parkford* v. *Commissioner*, 45 B.T.A. 461, affirmed 133 F. 2d 249, 9th Cir., 1943. On petition for rehearing in the lower Court, which was granted (see text, p. 414 of 238 F. Supp. 407), the trial Judge elaborated upon the Stuart case, but the Court in disposing of the Stuart case said that it was of the opinion that the Stuart case was directly contrary to the overwhelming weight of authority of said point as previously cited by the Court, and the Court declined to follow the Stuart case.

The question now presented for decision by this Court is whether the doctrine of the Stuart case is still the law. The petitioners contend that the law enunciated in that case has never been rejected and that it is applicable to the case at bar. When all of the assets were turned over within the fiscal year August 1, 1958 to July 31, 1959, that constituted a payment to the extent as was subsequently determined and it all occurred within the same taxable fiscal year. The lower Court, as shown by the language in the opinion in 238 F. Supp. 407 (text, p. 409, second column), clearly did not understand the contention of the petitioners, nor did it clearly understand the difference between the Stuart case and the Parkford case. Just prior to that Court's portion of the opinion the Court had analyzed the Stuart case and recognized that that case was authority for the proposition that when a cash basis taxpayer who had a judgment entered against him in 1933, went into bankruptcy in 1934, the taxpayer was entitled to a business loss deduction for the tax year of 1934, because all of his assets passed by operation of law to the trustee in turn for payment to the creditors. The Court did misconstrue the theory of this case by saying that the fact that there was only one creditor who held a judgment brought about a different conclusion than if there had been several creditors. The Court also said that that case was authority that there would be a trade expense as being paid for purposes of Section 162 in the year 1934, even though the creditors were not actually paid within that fiscal or calendar year. That is what the petitioners contend is the applicable law in the case at bar.

However, the lower Court was confused about the holding in the case of *Parkford* v. *Commissioner*, 45 B.T.A. 461, affirmed 133 F. 2d 249, because that decision did not have any bearing upon the doctrine of the Stuart case.

The gist of the Parkford case is that the taxpayer, an individual, was nevertheless on an accrual basis. The taxpayer made his tax returns based upon an accrual basis. Since he had adopted the accrual basis and had accrued his debts as against his income there were no deductible debts at the time of bankruptcy. He would have received his tax deductions prior to bankruptcy for any deductible debts or expenses theretofore incurred. Obviously he had no deductible loss at bankruptcy when he parted with his property to pay debts for which he had already received a deduction. Under Section 162, in the case at bar, when these accounts had been accrued by operation of law, the ultimate net value of the distributable estate was paid to or passed to the Trustees in Bankruptcy on June 26, 1959, and under the provisions of Section 70 of the Bankruptcy Act not only possession but title passed to the Trustees in Bankruptcy. This was not a contingent payment. This was not a substitute type of payment. As Judge Brown in the dissenting opinion of December 1, 1966, held, this was a direct payment, unconditional and subject only to the time which it took in the Bankruptcy Court to make the ultimate distribution to the creditors.

The Government has admitted all of the factual matters as set forth in the pretrial stipulation, and we say implicitly it was stipulated by the Government that if the Trustees had been able to make the distribution to the creditors within the five weeks still remaining in the 1959 fiscal year, this would have constituted the payment and, therefore, an expense and that the loss could be carried back to 1956. Actually the sole question as we construe it on behalf of the petitioners is who is charged with the necessary and consequent delay in the liquidation and payment to the actual creditors.

The lower Court and two of the members of the panel of the Appellate Court said that the payment was not made by July 31, 1959, or within the same fiscal year. Judge Brown, as the author of the dissenting opinion, says that it was. In our opinion this is a question that has not ever been definitely decided by any Court on the level of the Tax Court or of the Federal Appellate Courts or this Court, with the exception of the definite holding by the Tax Court at the time when it was entitled "Board of Tax Appeals" in the Stuart case, supra. This is an important question of the construction of the federal laws covering taxes, as well as an important and unsolved question in the administration of the National Bankruptcy Act, over which this Court has supervisory jurisdiction to the end that the administration of the National Bankruptcy Act shall be uniform throughout the country.

Judge Brown pointed out in the dissenting opinion that under Section 63 of the Bankruptcy Act, 11 U.S.C.A., § 103, all claims are matured under date of the bankruptcy, and that at the instant of bankruptcy the title to the assets vests in the trustee, in trust for the creditors, pro rata according to the debts held by them as of that same instant. It is pointed out that the payment doctrine, as recognized by the District Court in its opinion, was met when the payment was in cash, or its equivalent in property.

There still remains a question which has not been definitely settled, even under the dissenting opinion, as to the effect of the filing of the Chapter XI proceeding on the first day of the new fiscal year, August 1, 1958. None of the Courts' opinions that we have been able to find have ever passed squarely upon the effect of a Chapter XI petition being filed, and as to whether Section 63(a) of the Bankruptcy Act, 11 U.S.C.A., which matures all of

the debts of a bankrupt on the date of the bankruptcy, applies equally to a Chapter XI arrangement proceeding. The petitioners have submitted that question for determination both in the lower Court and in the Appellate Court. Under the provisions of Chapter XI (Arrangements), U.S.C., Title 11, Chapter 11, Section 799, the very first two provisions, Sections 301 and 302, the provisions of Section 63 of the Bankruptcy Act are applicable because of a special insertion in the Chapter XI features. Under Section 307, paragraph (1), it is provided:

> "(1) 'creditors' shall include the holders of all unsecured debts, demands, or claims of whatever character against a debtor, whether or not provable as debts under section 63 of this Act and whether liquidated or unliquidated, fixed or contingent."

This Court in the case of *John Nicholas, Trustee of the Estate of Beachcomber Motel, Inc., Bankrupt,* 384 U.S. 678, 86 S. Ct. 1674, decided June 13, 1966, passed upon a set of facts of a similar type involved in this case. It appears that on August 6, 1958, Beachcomber Motel, Inc., a Florida corporation, filed an original petition for an arrangement with its unsecured creditors under Chapter XI, Bankruptcy Act, § 322, 11 U.S.C., § 722. After the operation by the debtor in possession for a short time the arrangement failed and an adjudication in bankruptcy ensued. In the body of that opinion, and we quote from 86 S. Ct. 1674, text 1679, second column, the Court said:

> "We believe that the decisions of this Court in *Sexton* and *Saper*, reflect the broad equitable principle that creditors should not be disadvantaged *vis-a-vis* one another by legal delays attributable solely to the time-consuming procedures inherent in the administration of the bankruptcy laws."

In note 11 referred to in said opinion, this Court quoted with approval from the opinion of this Court in

Sexton v. *Dreyfus*, 219 U.S. 339, 31 S. Ct. 356, 55 L. Ed. 244, as follows:

> " 'The rule is not unreasonable when closely considered. It simply fixes the moment when the affairs of the bankrupt are supposed to be wound up. If, as in a well known illustration of Chief Justice Shaw's Parks v. City of Boston, 15 Pick. 198, 208, the whole matter could be settled in a day by a pie-powder court, the secured creditor would be called upon to sell or have his security valued on the spot, would receive a dividend upon that footing, would suffer no injustice, and could not complain.' "

The question now arises as to whether under the principles laid down in the Nicholas case, supra, the payment of the creditors as a matter of law was timed or fixed as the date of the adjudication in bankruptcy, June 26, 1959, regardless of how long it took the Trustees in Bankruptcy to liquidate and pay each creditor his proportionate dividend. If this Court should apply the same doctrine in the case at bar as it enunciated in the Nicholas case, then clearly the lower Court in the case at bar and the majority opinion of the United States Court of Appeals, Fifth Circuit, was clearly erroneous, and the opinion expressed by Judge Brown in the dissenting opinion should be the law applicable. While Judge Brown in his dissenting opinion recognized the impact of the filing of a Chapter XI proceeding, he did not clearly rule that as of August 1, 1958, the corporate affairs were automatically under an accrual basis as to the unpaid open accounts when they came into the hands of the Trustees in Bankruptcy on June 26, 1959. Judge Brown simply consolidated both of these factors in holding that the combination of circumstances and the effect of Section 70 was to amount to a payment pro tanto of the creditors.

The above statements of the questions involved as presented are all directed towards the claim deductions under 26 U.S.C., § 162. Further questions are presented under the second theory of claim for deduction under 26 U.S.C., § 165, for a business loss because of the divesture of the bankrupt's assets to the Trustees. The lower Court in its first opinion, 238 F. Supp. 407, at page 411, analyzed the second claim under Section 165, and in substance said that it could not recognize the applicability of Section 165 as being in any essential way different from its claim under Section 162. The essential feature of Section 165 provides in part:

> "There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise."

The lower Court could not see any distinction between the two claims—one, the loss under Section 162, and the other, the loss under Section 165, because the Court completely overlooked sub-section (b) of Section 165 of the Internal Revenue Code of 1954, which is as follows:

> "(b) For purposes of subsection (a), the basis for determining the amount of the deduction for any loss shall be the adjusted basis provided in section 1011 for determining the loss from the sale or other disposition of property."

Section 1011 of the Code referred to in sub-section (b), in effect provides that the taxpayer for this deduction can claim no more than the undepreciated portion of the asset, that is, the deduction is decreased by the depreciation previously taken and the salvage value of the asset. In the instant case the packing house and its machinery were singled out and the undepreciated cost claimed as a deduction because the unrecoverable cost

of the packing house and the packing house machinery was $457,735.00. This was computed by the unrecovered depreciable cost at the time of adjudication of the sum of $720,735.00 and the salvage value was stipulated to be $263,000.00, leaving a stipulated deductible remainder of $457,735.00, which in itself was more than enough if allowed as a deduction to effect recovery of the amount claimed. These amounts were stipulated in the pretrial stipulation (see Record, page 23).

Petitioners state that the question is presented as to whether under the provisions of Section 165, sub-sections (a) and (b), the Petitioners are entitled to a deductible loss in the amount above stated, and whether the District Court's order and that part of the order of the United States Court of Appeals, Fifth Circuit, was erroneous in the failure to recognize the loss under said Section 165.

In the petition for rehearing, which was directed to the opinion and judgment of the lower Court in the first opinion, as reflected and shown in the Transcript of the Record at page 56 (see actual discussion of the loss deduction under Section 165, beginning on page 69 of the Record), the Petitioners set forth that the reason for including a claim both under Section 165 and Section 167 was because of a confusion in Regulation 1.165-2(c), which reads as follows:

> "*Cross References.* For the allowance under Section 165(a) of losses arising from the permanent withdrawal of depreciable property from use in the trade or business or in the production of income, see § 1.167(a)-8. For provisions respecting the obsolescence of depreciable property, see § 1.167(a)-9. For the allowance of casualty losses, see § 1.165-7."

Because of the confusion in the regulations Petitioners in the Court below claimed that the losses would be

covered both under Sections 165 and 167, but the claim under Section 167 was abandoned on the appeal to the United States Court of Appeals, Fifth Circuit, under the claim that it was fully covered under Section 165, and that Petitioners were entitled to the construction and regulations that had been carried for many years under the similar code provision of the 1939 Code and temporary Regulations 39.23(e).

In its opinion on the petition for rehearing (see 238 F. Supp. 407, second column, page 414, and first column, page 415), in clarifying the first opinion the lower Court conceded that the regulation covering the construction of Section 165 would be the same as Regulation 39.23(e) of the 1939 Code, and said:

> "The regulation should not be interpreted to permit a 'loss' deduction simply because the taxpayer has physically given up its property.
>
> The question is always present under section 165 as to what was obtained in return for giving up any property. In the present case, liquidation of liabilities was obtained by the disposition of the property by the bankruptcy trustee. This was not a 'loss' and no deduction is authorized."

All of the three Judges sitting on the panel of the United States Court of Appeals for the Fifth Circuit affirmed the District Judge in this conclusion on the applicability of Section 165, and, therefore, the additional question is presented as to whether there was an erroneous ruling of law in the construction of the federal statute and the tax regulations applicable thereto.

STATUTES INVOLVED

Section 63 of the National Bankruptcy Act, 11 U.S.C., § 103; Section 70 of the National Bankruptcy Act, 11 U.S.C., § 110; Sections 301 and 302 of the National Bankruptcy Act, 11 U.S.C., §§ 701, 702; Section 307 of the National Bankruptcy Act, 11 U.S.C., § 707; 26 U.S.C., § 162; 26 U.S.C., § 165; Section 172, I.R.C., 1954; I.R.S. Temporary Regulation 39.23(e). Attached to this petition as Appendix "D", beginning at page A17, all of these statutes and regulations are set forth in full.

STATEMENT

Despite the fact that it has been through the throes of bankruptcy, B & L Farms Co. was at one time a very profitable operation. For its fiscal year ending July 31, 1955, after various adjustments were made, it paid a total income tax of $1,013,508 (R. 22). For its fiscal year ending July 31, 1956, after adjustments, it paid a total of $162,538.73 (R. 22), which is sought to be recovered here. The company had no earnings after the end of its year 1956 (R. 22), and, as a result of a freeze occurring during the Winter crop year of 1957-58, B & L Farms Co.'s operations for the year ending July 31, 1958, showed liabilities of $3,000,000.00, of which approximately 2.5 million was for deductible operating expenses (R. 29, 30), which, because the company was on a cash basis (R. 21), had not been accrued on the books of the company and could not be carried back against the tax of $1,013,508.00 paid for the fiscal year ending July 31, 1955. In the face of this insurmountable operating loss, on August 1, 1958 (which was the beginning of the fiscal year in which the adjudication occurred), B & L Farms Co. filed a petition under Chapter XI of the Bankruptcy Act whereby it proposed

to pay creditors in full (R. 21). A receiver was appointed to operate the company; however, the odds were apparently against success, and on petition of several of the creditors, the corporation was adjudicated a bankrupt on June 26, 1959. Trustees in Bankruptcy were appointed on that date by the Referee in Bankruptcy with instructions to liquidate the corporation (R. 21). The facts show that the assets turned over to the Trustees in Bankruptcy will pay little, if any, more than 50% of the claims of unsecured creditors, which claims are made up of the $3,000,000.00 in liabilities for which the corporation was obligated at the end of its fiscal year ending in 1958 (R. 24, 25). As stated before, 2.5 million of this 3 million in liabilities was for operating expenses not previously deducted.

Of the depreciable assets of the bankrupt corporation, at the time of the bankruptcy, was a packing house with machinery, the total unrecovered depreciable cost of which, after depreciation was taken, was $720,735.00 (R. 23). At the time of the adjudication, the salvage value of this asset was $264,000.00 (R. 31), leaving an unrecovered difference of $456,735.00 which is undisputedly a loss. The Stipulation of Facts entered into between the parties shows that upon adjudication, the farming operations of the company were terminated and that the packing house and machinery were not operated by the trustees (R. 21, 23).

For its fiscal year ending July 31, 1956, the corporation made a profit and after various audits and adjustments for subsequent losses, a total tax liability of $162,538.73 was determined. This tax was paid and no part of this amount has been refunded the taxpayer (R. 22).

As the tax burden has increased Congress has, in the case of business operations, given the taxpayer a measure of relief by not requiring him to compartmentalize a busi-

ness operating loss in one taxable year, but under § 172 (b) of the 1954 I.R.C., has authorized the taxpayer to carry back a loss to each of the three taxable years preceding the year of the loss, and if not used up in these three years, then to carry the loss forward for five taxable years. Since 1956 was the last year in which B & L Farms had taxable earnings, the losses occurring in the fiscal year ending in 1959 are important in that they are the last losses which can be carried back. It should be noted here that the figures of $162,538.73, taxes paid in the year 1956, is after adjustment for carry back losses which the Government ceded. What the taxpayer seeks to do here is establish that it had additional deductions which, when allowed in the year ending in 1959, result in a net operating loss for that year far in excess of $312,574.00, the amount of adjusted profit for the year ending 1956, upon which final assessment of taxes was made by the Internal Revenue Service. These deductions, when attributed to 1959 operations create losses, which when carried back to 1956 result in the taxpayer being entitled to a refund of its entire tax liability for that year. Fundamentally the Government does not dispute the fact that if the deductions are allowable in the year 1959, Plaintiffs' established losses would result in recovery of the entire tax liability. The Defendant's prime contention is that the loss did not occur during the 1959 fiscal year.

REASONS FOR GRANTING THE WRIT

Under *Title 28, U.S.C., Section 1254*, the Supreme Court of the United States is authorized to review by writ of certiorari any civil or criminal case in any United States Court of Appeal before or after rendition of judgment or decree. From a technical viewpoint this case is not a petition for certiorari from direct proceedings in a Bank-

ruptcy Court, but it is of interest to note in bankruptcy matters, under *Title 11, U.S.C.*, § *24(c)*, it is provided:

> "The Supreme Court of the United States is hereby vested with jurisdiction to review judgments, decrees, and orders of the United States courts of appeals in proceedings under this Act in accordance with the provisions of the laws of the United States now in force or such as may hereafter be enacted."

This Court has long adopted the policy in bankruptcy cases of supervising the uniform operation of the bankruptcy laws to end conflicts, and this power is not limited solely to the question where it appears that the only conflicts are in the various opinions of the United States Courts of Appeal. See the case of *Cline* v. *Kaplan*, 323 U.S. 97, 65 S. Ct. 155, and reference made in said case to the prior opinion of the Court where certiorari was granted, 323 U.S. 691, 65 S. Ct. 67, where the Court said:

> "Conflicting views having been expressed in different circuits on matters affecting bankruptcy administration which ought not to be left in doubt, we granted certiorari."

This Court has uniformly granted certiorari in its position as the supervisor of the bankruptcy laws, which is not limited entirely to where the question of the conflict is between two United States Courts of Appeal. This is further emphasized by the opinion of this Court in the case of *John Nicholas, Trustee of the Estate of Beachcomber Motel, Inc., Bankrupt*, 384 U.S. 678, 86 S. Ct. 1674. It is true that in that case this Court took jurisdiction of a bankruptcy matter reviewing certain tax statutes of the United States as to the liability of the trustee, and there was apparently a conflict between the United States Court of Appeals for the Fifth Circuit and the United States Court of Appeals for the Eighth Circuit, yet this

Court having taken jurisdiction reviewed the statutes of the United States relating to taxation. Whether this was done solely because of the conflict between two United States Courts of Appeal or whether it was for the purpose of acting in a supervisory capacity for the benefit of uniform construction of the bankruptcy law is not too clear from the opinion. However, we say that the same principles are involved, although not strictly in a bankruptcy proceeding.

In the case of *United States* v. *Ohio Power Company*, 355 U.S. 98, 77 S. Ct. 652, this Court had previously denied certiorari concerning the construction of a tax statute of the United States Internal Revenue Code. A petition for rehearing was also denied, but after the time period of the rules had expired this Court recalled its opinion of denial of the certiorari in the interest of justice and for the purpose of having uniformity in the construction of the Internal Revenue Code of the United States.

In the case at bar the Board of Tax Appeals in the case of *Stuart* v. *Commissioner*, 38 B.T.A. 1147, a copy of the opinion in said case being attached hereto as Appendix "C", squarely passed upon the same situation under the tax statutes as is involved in this case. There has been no opinion so far as we can find by any prior opinion of the United States Court of Appeals, or by this Court, which has ever, directly or indirectly, rejected the rule in the Stuart case, supra, until the decision of the United States District Judge, Southern District of Florida, in this case in the opinion reported in 238 F. Supp. 407.

The Stuart case was the law of the Board of Tax Appeals and the subsequent Tax Court of the United States, and it stood unchallenged for many years. It is the contention of the petitioners that when this tax controversy

arose in 1959 that decision of the Board of Tax Appeals (U. S. Tax Court) was not only persuasive, but was binding upon the Commissioner of Internal Revenue where there had been no substantial changes in the United States Tax Code or in the regulations. We have not been favored with any specific citations presented by the United States or by the United States District Court, or even by the majority opinion of the United States Court of Appeals for the Fifth Circuit, which would justify the legal conclusions reached by the United States District Court or the United States Court of Appeals for the Fifth Circuit in the majority opinion. The dissenting opinion by Judge Brown discloses that there are no opinions that had been brought to his attention when he reached the conclusion in the dissenting opinion that the petitioners' claim on behalf of the creditors of the bankrupt estate was well founded.

In a sense this is a case of first impression, with the exception of the decision in the Stuart case in the Board of Tax Appeals. This is a controversy that will necessarily arise in many bankruptcy cases. We, therefore, submit that the principles of law on the following questions have not ever been definitely determined, with the exception of the rule laid down in the Stuart case which was favorable to and supports the claim of the petitioners. The effect of the opinion in this case both by the United States District Court, Southern District of Florida, and the United States Court of Appeals for the Fifth Circuit, leaves undecided the following questions of law:

> Where a cash basis taxpayer is adjudicated a bankrupt, the transfer of its assets to a trustee in bankruptcy operates to give the bankrupt a tax deduction in the year of adjudication to the extent of the taxpayer's undeducted operating expenses for either of the following three reasons:

(A) Under the Bankruptcy Act, a bankrupt keeping its books on a cash receipts and disbursements method of accounting is required to close its books of account as of the date of adjudication in bankruptcy and as of that date by operation of law is transferred to an accrual method of accounting, or

(B) The unconditional transfer of assets from the bankrupt to the trustees in bankruptcy constitutes payment by the bankrupt for theretofore undeducted deductible expenses, or

(C) Divestment of all of the taxpayer's business property for the payment of deductible operating expenses by an adjudication in bankruptcy and appointment of trustees entitled the taxpayer to a deduction under § 165 of the Internal Revenue Code.

Regardless of whether a conflict between the United States Court of Appeals decision and the decision of the Board of Tax Appeals of the United States (U. S. Tax Court) would not of itself justify this Court to take jurisdiction on certiorari, this case does present an important and far-reaching federal question of the construction of Sections 162 and 165, United States Internal Revenue Code of 1954 as amended, as to its application generally, as well as in bankruptcy matters. A review by this Court is essential not only in the interest of justice, but for the purpose of protecting and establishing a uniformity of construction.

ARGUMENT

The petitioners present a very limited argument in this portion of the petition for certiorari, because in view of the record a lengthy argument would be pure repetition.

The record submitted to the Appellate Court consisted of 89 printed pages and only the opinion of the Court and petition for rehearing and orders thereon have been added by the Clerk, so that the entire record is comparatively small. We have produced and filed with this Court one certified copy of the printed record and nine additional copies.

A reference to the record discloses that a simplified pretrial stipulation was entered into between the parties (R. 20). The items shown from page 20 to the top of page 24 are all stipulated and much of the factual background which is carried in the opinion of the lower Court (238 F. Supp. 407) is taken from that stipulation. Beginning on page 24 of the record there are allegations of factual matters which the petitioners relied upon, but which had not been agreed upon by the Government. However, the findings of the lower Court established those factual matters and it was finally determined that the Trustees on June 26, 1959, received approximately $200,000.00 in cash, and that the salvage value of the packing house and machinery did not exceed the sum of $263,000.00.

In the said stipulation (R. 26) the position of the plaintiffs below, the petitioners herein, was analyzed, but the basis of the defense for the Government was not clearly set forth. This pretrial stipulation was amended (R. 29) and the actual factual matters which had been submitted by the plaintiffs in the first stipulation were agreed to by the Government, as reflected on pages 29 through 31 of the record. This stipulation, as shown in the record beginning at page 31, specifically set up the defendant's objections to the claim. The first objection was directed to the claim under Section 162, 26 U.S.C. The Government simply contended that although these trade accounts payable amounting to $2,459,618.00 were due and owing, since the corporation had not paid those

accounts and since the corporation was on a cash receipts and disbursements basis, they could not be used in computing losses which would give rise to deductions. The Government further contended that "prior to adjudication in bankruptcy, these trade accounts were not recorded as liabilities on the Company's books and are not reflected in the computation of capital and surplus stated in Paragraph IV(e) of the Pre-Trial Stipulation". It was admitted that the amount of the actual operating accounts, referred to as the trade creditors, represented 82% of all of the unsecured claims. There was no dispute about the actual amount of the losses either under Section 162 or Section 165. However, with reference to the losses claimed under Section 165 or 167 the Government made the additional claim by way of defense that a transfer by operation of law at the time of bankruptcy, even though there was an admitted fact of loss over and above the depreciation factors, did not give rise to a deductible debt for income tax purposes.

The last two paragraphs of the pretrial stipulation (R. 32) sum up the issues, and we quote:

> "Even if the taxpayer suffered a loss by going into bankruptcy, it is not the type of loss contemplated by § 172 of the 1954 Code which may be carried back and applied against prior years' income.
>
> VIII. The parties hereby agree that, should the Court determine the issues presented in favor of the plaintiffs, the parties will agree upon a computation of the amount of taxes and interest refundable and present the computation for the entry of Judgment."

The opinion of the District Court, filed June 25, 1964, and reported in 238 F. Supp. 407, is carried in full in the record beginning at page 41 through page 55.

When this opinion and the subsequent judgment was entered on that opinion, the judgment being shown in the record at page 55, the plaintiffs below, the petitioners herein, filed a comprehensive motion for new trial, rehearing and to alter or amend judgment and opinion (R. 56-78). In that motion numerous authorities were set forth, to which we refer rather than to extend the argument in this petition by a mere repetitious submission of extensive authorities.

Beginning on page 66 of the record the plaintiffs below, the petitioners herein, thoroughly discussed the "payment theory" and losses claimed under Section 162. On page 69 of the record there is reflected the analysis of authorities under the loss claimed under Section 165. Extensive quotations from the case of *Stuart* v. *Commissioner*, 38 B.T.A. 1147, were set forth, as shown in the record on pages 70, 71 and 72.

In the record on page 73 the Court will find a discussion and analysis of the case of *Parkford* v. *Commissioner*, 45 B.T.A. 46, affirmed 133 F. 2d 249, and it was pointed out that the Parkford case, which was relied upon by the lower Court as overruling the doctrine in the Stuart case, was not applicable.

Beginning on page 74 of the record the Court will find the analysis of the loss claimed under Section 165, which is based upon a loss measured by the difference between the unrecovered depreciable cost of the property and its salvage value. It was particularly pointed out that Section 165 of the 1954 Code was not covered by any new regulation in 1959, but that the temporary regulation, 39.23(e), was the controlling regulation. It was pointed out that this same situation had been passed upon by the Court of Claims in the case of *S. S. White Dental Manu-*

facturing Co. v. *United States,* 55 F. Supp. 117, which sustained the same position claimed by the petitioners. Regulation 39.23(e) was referred to and provides in part as follows:

> "*Loss of Useful Value.* When through some change in business conditions, the usefulness in business of some or all of the capital assets is suddenly terminated so that the taxpayer *discontinues the business or discards such assets permanently from use in such business,* he may claim a loss for the year in which he takes such action * * *."

In the second opinion by the lower Court (R. 79) the Court did recognize that Regulation 39.23(e) under the 1939 Code might sustain the position of the petitioners, but nevertheless it held that even under Regulation 39.23 (e), and assuming it was applicable, the plaintiffs below had not established the loss of useful value by proving "some objective loss of value has occurred, and which loss of value has caused the discarding of the property".

Special Argument with Reference to "Payment Doctrine" under Section 162

Some confusion has arisen in the treatment of the question as to whether the claim of the petitioners under Section 162 should be allowed. The dissenting opinion of Judge Brown, a copy of which is made a part of the appendix hereto, and which is also certified in the record, is a short but thorough analysis of the position of the petitioners in that regard. There is no dispute about the merits of that claim or the fact that these debts were due and owing. The dissenting opinion makes reference to the previous Chapter XI proceeding which was filed on the first day of the new fiscal year, August 1, 1958, to and including July 31, 1959.

Under the stipulation of counsel and under the admitted facts in the case there was an arrangement proceeding. All of the title to the assets passed to either the debtor in possession under Chapter XI, or into such receiver or trustee as the Court might appoint. The debtor was not left in possession, but a receiver was appointed. All debts owing by the corporation became due and payable forthwith. All accounts payable, which included some $3,000,000.00, of which 82% represented the trade creditors, became accrued and due and payable. A Chapter XI proceeding, as we have heretofore pointed out, works two ways. It not only accrues all debts of the corporation whether on the books or not, but it also accrues all assets or accounts receivable whether due or not, as long as they are in the class of a general creditor.

The Government's position is that after the Chapter XI proceeding was filed, and even admitting that the accounts of creditors of the corporation became due and payable forthwith, the accounts payable for these trade creditors did not simultaneously become accrued. We say that position is untenable under the established law as set forth in the Chapter XI bankruptcy proceedings. All receiverships or trusteeships, whether they be under state laws or federal laws, or even in probate proceedings, are controlled by accruals and all accounts are mutually due and payable regardless of what type of accounting had been practiced by the taxpayer prior thereto. Many other provisions of the Bankruptcy Act, including the right of set-off, would be utterly voided if this were not the case. The operation of the receiver or trustee is a necessity on an accrual basis. Otherwise no plan or arrangement or even liquidation could be entertained. Suppose, for example, the receiver who had title to the assets under the Chapter XI proceeding and who was operating the busi-

ness elected to sell the assets, either partially or entirely, and applied the proceeds to the payment of the debts. Could it be argued successfully by the Government that the receiver or trustee under a Chapter XI proceeding would not have to prorate those payments to all of the creditors, including the trade creditors? If this had been done during the Chapter XI proceedings and if the Chapter XI proceedings had continued for the full 1958-1959 fiscal year, there is no question but what the losses would have been allowed and the Chapter XI trustee or receiver would have had a right to go back to the 1956 fund and claim a refund.

The United States District Court had complete jurisdiction of the assets. It could have ordered partial liquidation and partial payment on all of the unsecured creditors pro rata, and even without any sale of property certainly the $200,000.00 in cash could have been applied. If the packing house and machinery had been disposed of during the Chapter XI proceedings, the losses contemplated under Section 165 would have been allowed and the receiver or trustee in Chapter XI would have been entitled to the refund claim. When the bankruptcy procedure was instigated on the application of certain of the creditors and the adjudication was entered on June 26, 1959, within five weeks of the end of the same fiscal year, why was there any different legal situation involved? One distinct feature of the bankruptcy adjudication was the simultaneous order to stop the operation of the business and to liquidate. Let us suppose for the sake of argument that the bankruptcy adjudication had taken place in February or March, 1959 instead of June 26, 1959, and the Trustees in Bankruptcy had liquidated and made partial distribution to creditors before the end of the 1958-1959 fiscal year. Certainly the Government could not contend there had been no payment made to

creditors. We propose another example—suppose on June 26, 1959, or several days thereafter, the $200,000.00 in cash was ordered by the federal Court to be distributed pro rata to those creditors. That would have been a simple way, because all of the accounts had been settled and that was possible. Just because the necessary procedures of delay in bankruptcy prevented the Trustees in Bankruptcy from moving fast enough to make partial liquidation within the five weeks before the end of the fiscal year, why should the innocent general creditors be penalized? The bankrupt corporation had thrown all of its assets by operation of law into the bankruptcy and if the date of the bankruptcy is the controlling date, payment pro tanto or pro rata had been made for the value not only of the cash passed, but of the property.

Admittedly in 1959, there was some question as to whether refunds for loss carry-backs actually passed to the Trustees and the uncertainty about that law may have been one of the factors that influenced the lower Court, because special comment is made by the lower Court in the first opinion (R. 54) wherein the Court expressed the idea that the title to these refund claims did not go to the Trustees. However, any question in that regard was settled by this Court in the case of *Gerald Segal* v. *William J. Rochelle, Jr., Trustee,* 382 U.S. 375, 86 S. Ct. 511, opinion dated January 18, 1966. This Court definitely held that because of conflicts in other Court of Appeals decisions these claims for refunds actually passed to the trustee. Judge Brown, in the dissenting opinion of December 1, 1966, and perhaps being influenced by this most recent decision of this Court on the subject pointed out that the majority opinion had failed to give the proper construction to Section 70(a)(5). The majority opinion in the December 1, 1966 decision, as pointed out by Judge Brown,

is directly in conflict with the opinion of this Court in the Segal case, supra. We think it would be sufficient only to say with reference to the claim under Section 162 that if the majority of the Court had even considered the Segal opinion, supra, and given it the weight to which it was entitled, Judge Brown's dissenting opinion would have been the majority opinion of the Court. If this doctrine of the Segal case had been properly applied and the doctrine of the opinion of this Court in the Nicholas case, supra, had been properly applied, then certainly the opinion of the majority was wrong.

Loss Claimed on Account of Packing House and Machinery

The Government's position with reference to the above item and as adopted by the lower Court and the majority opinion of the Appellate Court is based upon the contention that the identifiable event or, as expressed by the opinion of the lower Court, objective loss, must either be a sale of the assets or physical abandonment thereof where it can not or will not be retrieved for any salvage value. We say this is not the law.

Petitioners' contention is that there was a change in business conditions which suddenly caused the permanent discontinuance of the taxpayer's business and the usefulness of the packing house and its machinery in its business, whereby it suffered a large loss. The forced discontinuance of the business caused by economic forces beyond its control, is the identifiable event which fixed the year of the loss deduction.

Obsolescence has been classified by the Commissioner into separate categories, namely, "normal" and "extraordinary or special". Normal obsolescence according to his classification is to cover a situation where obsolescence

becomes predictable in a year prior to the termination of its usefulness. This has the effect of treating "normal" obsolescence as a part of the depreciation and deductible under § 167 of the Code. Since "extra or special obsolescence" has been defined as a sudden loss of usefulness which usually cannot be predicted before it actually occurs, it partakes of a loss which usually occurs in one year and recovery was authorized by regulation under the loss statute, § 165 of the Code. (*Mertens on Taxation,* Vol. IV, § 23.105). This classification has caused considerable confusion.

It has long been held discontinuance of a business caused by forces beyond the control of the taxpayer gives rise to an obsolescence deduction. There are many cases under the prohibition law which caused the discontinuance of business engaged in the manufacture and sale of intoxicating liquors. In *Burnet* v. *Niagara Falls Brewing Co.,* 282 U.S. 648, 51 S. Ct. 262, the Supreme Court held that the imminence of prohibition was foreseeable in January, 1918, and took effect in January, 1920, and a taxpayer could spread his loss (book value less salvage value) over that period. In *Rodeo-Vallejo Ferry Company* v. *Commissioner,* 24 B.T.A. 936, the court held that where the building of a bridge would cause a discontinuance of its business, the loss (book value less salvage value) could be spread over the period from the beginning to completion of the bridge. In *United States* v. *Wagner Electric Mfg. Co.,* (C.C.A. 9, 1932) 61 F. 2d 204, a large obsolescence loss of a shell making plant and machinery was allowed due to termination of the First World War, part in the year 1918 and 1919, when the manufacture of shells would cease. The court stated:

> "There is no hard and fast rule as suggested by the government, that a taxpayer must show his prop-

erty will be scrapped or cease to be used or be useful for any purpose before any allowance may be made for obsolescence."

In the foregoing cases the deduction was allowed under the depreciation statute, now § 167, I.R.C., presumably because the discontinuance of the business was predictable in a future year.

This rule was criticized and not followed, however, by the Ninth Court of Appeals. In *Keller Street Development Co.* v. *Commissioner,* (1963) 323 F. 2d 166, the court could see no logical reason why an obsolescence loss would be allowed if spread over 13 months and be denied where it occurred over a period of less than 12 months.

There is no logical reason why an obsolescence loss on account of discontinuance of a business should be allowed where it is predictable and denied where it happens suddenly and is not predictable.

Regulation 39.23(e)-3 of the 1939 Code specifically states that where through some change in business condition, the usefulness in business of some or all of its assets is suddenly terminated so that the taxpayer discontinues his business he may claim the deduction in the year in which he takes such action. It is submitted that a loss may be claimed under this regulation as it was in full force and effect as a temporary regulation under the 1954 Code (see T.D. 6991, F.R. 5167, August 17, 1954). The Government contends that permanent regulation 1.167(a) 8, adopted in 1960, is retroactive and changes the law applicable to our case.

In the first place, the Commissioner does not have the power to change the law. Administrative regulations are interpretive of the statute which the administrator is empowered to enforce, and are persuasive as to the in-

terpretation given. Where a statute has been enacted and re-enacted, as is the case with § 165 I.R.C., 1954, under substantially the same administrative interpretation, the Commissioner cannot by regulation in 1960 change the prior acquired, substantive rights of parties involved. It has long been held that treasury regulations and interpretations thereof long continued without substantial changes, applying to amended or substantially re-enacted statutes are deemed to have Congressional approval and have the effect of law. *Helvering, Commissioner* v. *Winnell,* 305 U.S. 79, 59 S. Ct. 45; based on the foregoing previous interpretation of § 165(a) under prior regulations must still hold since this section of the I.R.C. has been in effect since 1918 or before.

In the second place, it is submitted that the Commissioner has not changed the interpretation of § 165(a) I.R.C., whether construed by the 1939 regulations or the revised regulations adopted in 1960 for the 1954 I.R.C. The regulations under § 165(a) I.R.C. 1954 (Par. 1.165-2 (c)), refers to regulations 1.167(a)-8 in the case of depreciable property permanently withdrawn from use in the trade or business or production of income. The old regulation, under former § 165(a) referred to discontinuance of the business; Reg. 1.167(a)-8 refers to the retirement of an asset from trade or business, an obvious result of discontinuance of the business. The loss here falls under retirement as set forth in Treasury Regulation par. 1.167 (a)-8 (3) and sub-par. (b), not sub-paragraph (4) relating to abandonment. The definition given in the regulation of the word "retirement" is certainly consistent with discontinuance of business. In fact, permanent discontinuance of business is certain proof that the assets have been retired from use in that business.

It will be noted that Reg. 1.165-2 with reference to obsolescence loss on account of non-depreciable property continues the deduction upon discontinuance of business. For many years, non-depreciable assets and depreciable assets were covered alike under Regulation 39.23(e) 3. There is no reason why the loss on account of non-depreciable property should continue to be allowed on discontinuance of a business, and loss on account of depreciable property should be denied in such event.

While it does not appear that the Commissioner clarified the law by the permanent regulations, if analyzed, it does not seem that he repealed any deductions theretofore allowed.

The court in *Keller Street Development Co.* v. *Commissioner* (supra) commenting on the permanent regulations said:

> "Keeping in mind that § 167 formerly 23 (1) of the 1939 Internal Revenue Code has remained substantially the same, we find treasury regulations apparently shifting in such a way as to obscure their meaning and make them of little help in interpreting the section in question. In 1942, it could be concluded from Bulletin 'F' (revised January 1942) that obsolescence could occur at practically any time."

The court held that the taxpayer could take obsolescence loss on account of machinery purchased for a new brewery when the taxpayer decided not to build a new brewery and continue in business because change in trade practices made their business unprofitable.

In *Mertens on Taxation*, Vol. IV, it is aptly stated that in principle the concept of obsolescence is simple and devoid of any mystery. Not unlike simple tax concepts, however, difficulty frequently arises in application. Ob-

solescence is, like ordinary depreciation, a question of fact in each case. Its existence must be established by proof and when that occurs, its allowability as a deduction is assured. (Also *Rodeo-Vallejo Ferry Co.* v. *Commissioner*, supra, to like effect.)

The fine-spun technical contentions of the Government overlook the basic reason Congress allows the deduction of depreciation and obsolescence whether the latter be classified as "ordinary" or, "extraordinary or special" or "loss of useful value".

The basic reason for depreciation is to give the taxpayer relief and a deduction from ordinary income for the loss of invested capital due to the "wearing out" of an asset. In fixing the time of such relief, depreciation rates are fixed at the time of acquisition of the asset, based upon the period of usefulness of the asset in the taxpayer's business. The basis of the so-called obsolescence deduction is that the taxpayer has suffered a loss of capital investment in the asset from a cause not contemplated in setting the applicable depreciation rates (Reg. § 1.167(b)). Obviously, termination of a business by prohibition laws, the building of a bridge, the ending of a war, change in competition which renders the taxpayer's business unprofitable, and bankruptcy, could not have been contemplated in fixing the depreciation rate. The unexpected financial loss is deductible when it in fact occurs.

In the present case, the pre-trial stipulation admits an economic loss of $456,735.00 on account of the packing house and machinery at the time the taxpayer was forced, against its will, to discontinue its business on June 26, 1959. It is stipulated that this loss existed on that date. Of the adjusted capital investment of $720,735.00, only salvage value remained. The amount of this salvage value

is stipulated to be $263,000.00. The amount of loss and time of loss are established by this stipulation. It should be allowed as a deduction in that year.

CONCLUSION

We respectfully say that this Court should grant the certiorari applied for herein. There is a scarcity of authority as to treatment of a bankruptcy or Chapter XI proceeding as an event or happening of one is required for the deduction under Section 165. The adjudication by the United States District Court for a corporation is a real event. The property and all right, title and interest thereto immediately vests in the trustee in bankruptcy. The officers, directors and stockholders are suddenly ousted of any control of the corporation. The employment of all other staff members or employees who have been operating the business automatically ceases, subject only to their right for back pay. Executory contracts are subject to termination. The right to continue as a going business for the protection of the good will, trade name and customer associations is immediately broken off. To say that nothing occurs when a corporation is adjudicated a bankrupt or that it is not an event that would trigger the operation of Section 165 is not facing the reality of the situation.

In 1959, there were no Internal Revenue Regulations in existence which specifically mentioned this situation. However, in 1961, regulations were adopted under Section 166 of the Code, the regulation referred to being 1.166-2. This regulation was added as of July 31, 1959, just shortly after the bankruptcy adjudication in the case at bar on June 26, 1959 (T.D. 6403, July 31, 1959, 24 F.R. 6160). This regulation and section of the statute are not directly in controversy, but we wish to bring to the Court's atten-

tion that in this regulation which deals with evidence of worthlessness of a creditor's claim and the right for the creditor to charge off all or part of a debt as a bad debt, the event of bankruptcy is recognized under Regulation 1.166-2, ¶ (c), as follows:

> (c) *Bankruptcy*—(1) *General rule.* Bankruptcy is generally an indication of the worthlessness of at least a part of an unsecured and unpreferred debt.
>
> (2) *Year of deduction.* In bankruptcy cases a debt may become worthless before settlement in some instances; and in others, only when a settlement in bankruptcy has been reached. In either case, the mere fact that bankruptcy proceedings instituted against the debtor are terminated in a later year, thereby confirming the conclusion that the debt is worthless, shall not authorize the shifting of the deduction under section 166 to such later year."

The sense of this regulation is certainly clear enough to prevent the Government through the Commissioner of Internal Revenue and his agents from contending that bankruptcy has no recognition and no place as a determining factor in the economic life of a corporation. If the mere action of the board of directors to give up the operation of a certain piece of property or the mere building of a bridge may have the effect of putting a ferry-boat company out of business, then why is not the involuntary adjudication of a corporation as a bankrupt such an event that will bring into being the protection and relief afforded by the law under Section 165?

We respectfully say that the petition for certiorari should be granted and the opinion of December 1, 1966 of the United States Court of Appeals for the Fifth Circuit

should be reversed and judgment entered for the petitioners.

Respectfully submitted,

WILLIAM GRESHAM WARD
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Miami, Florida 33131
Attorney for Petitioners

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a copy of the foregoing Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit has been mailed this ..... day of May, 1967, to the Hon. William A. Meadows, Jr., United States Attorney, P. O. Box 1070, Post Office Building, Miami, Florida, and Hon. Louis F. Oberdorfer, Assistant Attorney General, Tax Division, United States Department of Justice, Washington, D. C. 20530.

WILLIAM GRESHAM WARD